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# Q1 Earnings Recap: US Large-Cap Hanging In, Other Segments Showing Weakness

## US Small-Cap, Japanese, and Europe Less Strong

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SUMMARY

- US large-cap earnings have continued to grow and surprise to the upside.
- European and Japanese expected earnings buoyed by currency; US small-cap is struggling.
- While tariff impacts will not show up fully yet in earnings results, estimates have held up so far…which we view positively.

With over 90% of S&P companies now having reported, we feel we have enough data to perform our quarterly earnings season 'checkup'. In order to complete this checkup, we will use our three 'earnings principles':

1. **Earnings/Revenue Surprises:** Were corporate results out of alignment with market expectations?

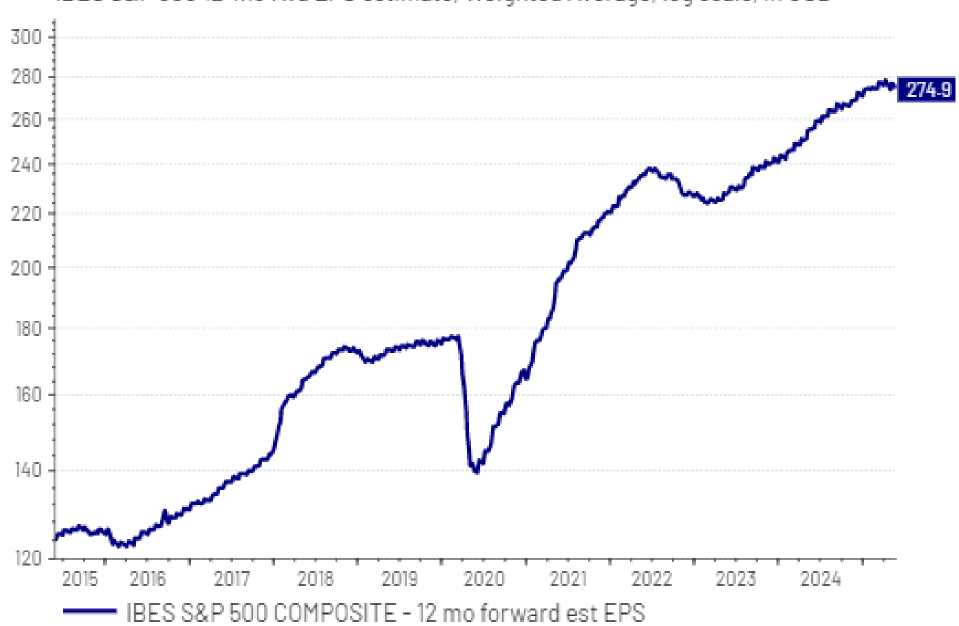
2. **Analyst Adjustments:** What was the direction and magnitude of analysts' estimate revisions after forward guidance was issued?

3. **Earnings/Revenue Trends:** What is the long-term earnings trend after the announcement?

Starting with the first principle, the S&P 500 posted another strong quarter relative to expectations; **earnings were +8% higher** than anticipated (source: Bloomberg), with every sector but Real Estate beating expectations. These results seem to corroborate our view that the combination of stable rates and sustained inflation levels between 2-3% percent has created an enviroment where 'high operating leverage' business models -ones with high fixed costs but low variable ones - can thrive. While we are encouraged by this earnings performance, we must continue to monitor the trends, given US policy volatility.

**Chart 1: Earnings Stable Despite Uncertainity**

IBES S&P 500 12-mo fwd EPS estimate, Weighted Average, log scale, in USD




*Source: LSEG Datastream, RiverFront. Data weekly as of May 28, 2025. Chart right shown for illustrative purposes only. Past performance is no indication of future results.*

From a revenue perspective, we were also encouraged by **sales coming in +0.8% higher than analysts expected**, with only Staples and Financials coming in below expectations.

Moving to our second principle, **future earnings expectations for the S&P 500 over the next 12 months remained largely stable** in response to positive earnings surprises (see Chart 1, above on page 1). This is critical in our view, since tariffs were announced after the end of Q1, so early signs of deterioration should start to show up here. To that end, we will be carefully watching surprises next quarter… but analysts' forecasts holding up in the midst of such an uncertain trade backdrop is a positive sign, in our view.

Finally, the annualized **trend of US large-cap earnings continues to be a positive +11.3% year over year** overall, supported by revenue growth of +4.2%. Important to our thesis, earnings for 'growth' sectors (Technology, Communication Services and Discretionary) all have strong earnings growth, as do Health Care companies. Energy and Materials are struggling due to higher financing costs and declining commodity prices, while Staples and Real Estate both face margin pressure from interest rate increases.

This healthy checkup for growth themes is critical for US large-capitalization stocks as our constructive view of US returns is predicated on a continuation of strong earnings. While the effects of tariffs still could reveal weak spots in future earnings, all indications are that, so far, **the price correction we saw at the end of the quarter was more a valuation reset than an early sign of a major earning correction in US large-cap stocks, in our view.**

## US Large-Cap Holding Up While Other Segments are Showing Weakness

| | US large-cap | US small-cap | Europe | Japan |
|---|---|---|---|---|
| Revenue Surprise | Positive | Flat (-) | Flat (-) | Flat (-) |
| Earnings Surprise | Positive | Positive | Positive | Negative (-) |
| Estimates for 2025 / 2026 | Positive | Positive (-) | Positive (+) | Positive (+) |
| Revenue Trend Growth | Positive | Flat (-) | Positive (+) | Positive |
| Earnings Trend Growth | Positive | Decelerating (-) | Decelerating (-) | Decelerating (-) |
| Source: Bloomberg Estimates: -/+ indicates change from prior quarter | | | | |

*Source: Bloomberg, RiverFront. Data quarterly as of May 15, 2025. Chart shown for illustrative purposes only. Past performance is no indication of future results. You cannot invest directly in an index. Not indicative of RiverFront portfolio performance. In the table above, US Large Cap is represented by the S&P 500, US Small Cap is represented by the S&P 600, Europe is represented by Euro Stoxx 50, and Japan is represented by Tokyo Price Index. See Disclosures section for definitions.*

The table above summarizes RiverFront's view of the earnings picture for four different market segments. Relative to US large-caps - which have a clear growth/technology bias – US small-caps, Europe and Japan all have a greater weighting in the more value-oriented sectors. As such, while we look for continued strength in US large-cap, in these other markets we instead are looking for improvement. Unfortunately, most of these other major segments outside of US large-caps have seen more mixed results. In the table above, the "+" and "-" signs indicate how things have changed since the previous quarter. The biggest trend to note is that, unlike US large-cap, each **of the other segments experienced deterioration in both surprises and in their growth rates.**

## Beyond Large-Cap: Other 'Value-Led' Market Segments Mixed…Europe Faring Better than Japan or US Small-Caps

- **US small-cap:** A perceived economic slowdown, some fear of tariffs, and  the Fed making clear that rate cuts would be fewer than were broadly expected all combined to create some meaningful deceleration in US small-cap from an earnings standpoint. Critically, unlike Europe and Japan, earnings estimates for small-cap have fallen in tandem with prices. This combination of falling prices, declining earnings and profitability and deteriorating fundamentals are creating the heightened possibility of a "value trap" in smaller companies, in our view.

- **Europe:** European equities, on paper, look to have had a rough go as well for Q1 earnings. However, we believe there are two things that are working in Europe's favor that might not be immediately apparent. The first is that estimates have strengthened meaningfully during this period, which means that combined with stronger than expected Q1 earnings, there is some evidence of the beginning of positive momentum in European earnings. The second is that our analysis looks at all earnings in local currency. This fact ignores the strength of the euro, which during the period significantly elevated the value of those earnings. Given our view that policymakers in the US are not seeking a strong dollar in the near term, we think it is likely that this elevation of European earnings in dollar terms will persist for some time.

- **Japan:** Results here are definitely better than US small-caps, but nowhere near as compelling as Europe, in our opinion. Japan benefitted from the yen gaining ground on the dollar, but its earnings and revenue growth numbers were all weak in local terms. Like Europe, it did benefit from increased expectations in earnings growth for the next couple of quarters, which is critical as Japanese equities stare down tariff risks.

## Conclusion: Still Favoring US Large-Cap Stocks; Beginning to Lean into Europe and International

The good news is that earnings expectations everywhere have not turned negative with the myriad announcements surrounding tariffs and the trade war. We have seen some small signs of weakness, but overall, our earnings analysis paints a cautiously optimistic picture for almost every segment, with small-cap being the notable exception given fundamental and interest rate headwinds it faces.

Our portfolios are positioned consistently with the takeaways of this analysis. We are overweight US large-cap stocks across our balanced portfolios. Our conviction on large-caps is due in part to their demonstrated earnings strength. We have also made selective investments in Europe and Japan, and have risk-managed small-caps out of our long-horizon portfolios. Over the next quarter, we will need to see some improvement in the realized earnings growth trends of European and Japanese markets. With the impact of tariffs creating uncertainty, we will be monitoring corporate surveys, business confidence, earnings guidance and analyst revisions to assess whether the risk of recession has increased

*Risk Discussion: All investments in securities, including the strategies discussed above, include a risk of loss of principal (invested amount) and any profits that have not been realized. Markets fluctuate substantially over time, and have experienced increased volatility in recent years due to global and domestic economic events. Performance of any investment is not guaranteed. In a rising interest rate environment, the value of fixed-income securities generally declines. Diversification does not guarantee a profit or protect against a loss. Investments in international and emerging markets securities include exposure to risks such as currency fluctuations, foreign taxes and regulations, and the potential for illiquid markets and political instability. Please see the end of this publication for more disclosures.*

*Stocks represent partial ownership of a corporation. If the corporation does well, its value increases, and investors share in the appreciation. However, if it goes bankrupt, or performs poorly, investors can lose their entire initial investment (i.e., the stock price can go to zero). Bonds represent a loan made by an investor to a corporation or government. As such, the investor gets a guaranteed interest rate for a specific period of time and expects to get their original investment back at the end of that time period, along with the interest earned. Investment risk is repayment of the principal (amount invested). In the event of a bankruptcy or other corporate disruption, bonds are senior to stocks. Investors should be aware of these differences prior to investing.*

*In general, the bond market is volatile, and fixed income securities carry interest rate risk. (As interest rates rise, bond prices usually fall, and vice versa). This effect is usually more pronounced for longer-term securities). Fixed income securities also carry inflation risk, liquidity risk, call risk and credit and default risks for both issuers and counterparties. Lower-quality fixed income securities involve greater risk of default or price changes due to potential changes in the credit quality of the issuer. Foreign investments involve greater risks than U.S. investments, and can decline significantly in response to adverse issuer, political, regulatory, market, and economic risks. Any fixed-income security sold or redeemed prior to maturity may be subject to loss.*

*Investing in foreign companies poses additional risks since political and economic events unique to a country or region may affect those markets and their issuers. In addition to such general international risks, the portfolio may also be exposed to currency fluctuation risks and emerging markets risks as described further below.*

*Changes in the value of foreign currencies compared to the U.S. dollar may affect (positively or negatively) the value of the portfolio's investments. Such currency movements may occur separately from, and/or in response to, events that do not otherwise affect the value of the security in the issuer's home country. Also, the value of the portfolio may be influenced by currency exchange control regulations. The currencies of emerging market countries may experience significant declines against the U.S. dollar, and devaluation may occur subsequent to investments in these currencies by the portfolio.*

*Foreign investments, especially investments in emerging markets, can be riskier and more volatile than investments in the U.S. and are considered speculative and subject to heightened risks in addition to the general risks of investing in non-U.S. securities. Also, inflation and rapid fluctuations in inflation rates have had, and may continue to have, negative effects on the economies and securities markets of certain emerging market countries.*

*Technology and Internet-related stocks, especially of smaller, less-seasoned companies, tend to be more volatile than the overall market.*

*Index Definitions:*

*Standard & Poor's (S&P) 500 Index measures the performance of 500 large cap stocks, which together represent about 80% of the total US equities market.*

*S&P 600 is a benchmark index for small-cap stocks. To be listed on the S&P 600, stocks must have a market cap of $850 million to $3.6 billion, preventing overlap with S&P's larger cap indices.*

*EURO STOXX 50 is a stock index of Eurozone stocks designed by STOXX, an index provider owned by Deutsche Börse Group. The index is composed of 50 stocks from 11 countries in the Eurozone. EURO STOXX 50 represents Eurozone blue-chip companies considered as leaders in their respective sectors.*

*The Tokyo Price Index, known as TOPIX, is a Japanese stock market index calculated and published by the Tokyo Stock Exchange (TSE). TOPIX tracks domestic companies in the exchange's first section, which represents Japan's largest firms by market capitalization.*

*Definitions:*

*Operating leverage is a financial ratio that, using a company's fixed costs relative to its variable costs, measures the degree to which a firm can increase operating income by increasing revenue.*

*A recession is a significant, widespread, and prolonged downturn in economic activity. A common rule of thumb is that two consecutive quarters of negative gross domestic product (GDP) growth indicate a recession. However, more complex formulas are also used to determine recessions.*

*Euro* is *the single European currency, which replaced the national currencies of France, Germany, Spain, Italy, Greece, Portugal, Luxembourg, Austria, Finland, the Republic of Ireland, Belgium, and the Netherlands in 2002. Twenty member states of the European Union now use the euro.*

*Yen is the basic monetary unit and official currency of Japan.*

*The energy sector is a category of stocks that relate to producing or supplying energy. The energy sector or industry includes companies involved in the exploration and development of oil or gas reserves, oil and gas drilling, and refining. The energy industry also includes integrated power utility companies such as renewable energy and coal.*

*US Equities include stocks listed in the United States. Stocks represent partial ownership of a corporation. If the corporation does well, its value can increase, and investors can share in the appreciation. However, if it goes bankrupt, or performs poorly, investors can lose their entire initial investment (i.e., the stock price can go to zero). Small/mid-cap equities, MLPs, REITS and alternatives equities are types of US Equities and assume further risks described below.*

*The Institutional Brokers' Estimate System (IBES) is a database used by brokers and active investors to access the estimates made by stock analysts regarding the future earnings of publicly traded American companies.*

*Earnings per share (EPS) is calculated as a company's profit divided by the outstanding shares of its common stock. The resulting number serves as an indicator of a company's profitability.*

*US large cap equities include equities of companies with a market capitalization of over $10 billion. Although large cap equities are generally considered to be safer securities, large cap equities are still subject to the risks associated with stocks.*

*Small-, mid- and micro-cap companies may be hindered as a result of limited resources or less diverse products or services and have therefore historically been more volatile than the stocks of larger, more established companies.*

*When referring to being "overweight" or "underweight" relative to a market or asset class, RiverFront is referring to our current portfolios' weightings compared to the composite benchmarks for each portfolio. Asset class weighting discussion refers to our Advantage portfolios.*

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